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James J. White

University of Michigan Law School, jjwhite@umich.edu

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GOOD FAITH AND THE COOPERATIVE ANTAGONIST

James J. White*

ONE of Karl Llewellyn's most noted achievements in the Uniform Commercial Code was to impose the duty of good faith on every obligation under the Uniform Commercial Code.¹ Some (I am one) have privately thought that imposition of this unmeasurable, undefinable duty was Llewellyn's cruelest trick, but no court, nor any academic writer, has ever been so bold or so gauche as to suggest that good faith should not attend the obligations of parties under the UCC. Notwithstanding this silent indorsement of the duty of good faith, the courts² and commentators³ have had difficulty in determining what is and what is not

* Robert A. Sullivan Professor of Law, University of Michigan Law School. I thank my colleagues Omri Ben-Shahar and Phil Soper for their comments, Gregory P. Schantz 01 for his research and Janis Proctor and Richard Sands for their secretarial work.

1. These obligations are no less prominent in Revised Article 1, and in some respects they are expanded. Revised Article 1 now adopts the expanded definition of good faith that originally applied only to merchants under Article 2, "honesty in fact and the observance of reasonable commercial standards of fair dealing." See U.C.C. §§ 1-304, 1-201(a)(22) (Draft, National Conference Of Commissioners On Uniform State Laws July 28 - August 4, 2000) available at <http://www.law.upenn.edu/bll/ulc/ucc1/ucc1070500.htm> (last visited Oct. 31, 2000).

2. See, e.g., *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333 (7th Cir. 1988); *Nanakuli Paving & Rock Co. v. Shell Oil Co.*, 664 F.2d 772 (9th Cir. 1981); *Marquette Co. v. Norcem Inc.*, 114 A.D.2d 738 (N.Y. 1985); *Corenswet v. Amana Refrigeration, Inc.*, 594 F.2d 129 (5th Cir. 1979).

3. See Steven J. Burton, *Symposium: The Revision of Article 2 of the Uniform Commercial Code Good Faith in Articles 1 and 2 of the U.C.C.: The Practice View*, 35 WM. & MARY L. REV. 1533, 1535 n.11-15 (1994). Prof. Burton notes at least five views ranging from Judge Posner's efficiency arguments to Roberto Unger's urging that to act in good faith is to exercise formal entitlements in the spirit of solidarity. See also Michael P. Van Alstine, *Of Textualism, Party Autonomy, and Good Faith*, 40 WM. & MARY L. REV. 1223 (1999); Saul Litvinoff, *Good Faith*, 71 TUL. L. REV. 1645 (1997); Scott McPhee, *First Down, Goal to Go: Enforcing the NFL's Salary Cap Using the Implied Covenant of Good Faith and Fair Dealing*, 17 LOY. L.A. ENT. L.J. 449 (1997); Royce De R. Barondes, *The Limits of Quantitative Legal Analyses: Chaos in Legal Scholarship and FDIC v. W.R. Grace & Co.*, 48 RUTGERS L. REV. 161 (1995); Claire Moore Dickerson, *From Behind the Looking Glass: Good Faith, Fiduciary Duty & Permitted Harm*, 22 FLA. ST. U. L. REV. 955 (1995); Larry A. DiMatteo, *The Norms of Contract: The Fairness Inquiry and the "Law Of Satisfaction"—A Nonunified Theory*, 24 HOFSTRA L. REV. 349 (1995); Douglas K. Newell, *Will Kindness Kill Contract?*, 24 HOFSTRA L. REV. 455 (1995); Christina L. Kunz, *Frontispiece on Good Faith: A Functional Approach Within the UCC*, 16 WM. MITCHELL L. REV. 1105 (1990); Stacy A. Silkworth, *Quantity Variation in Open Quantity Contracts*, 51 U. PITT. L. REV. 235 (1990); Susan A. Wegner, *Section 1-208: "Good Faith" and the Need for a Uniform Standard*, 73 MARQ. L. REV. 639 (1990); Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration: Of Llewellyn, Wittgenstein, and the Uniform Commercial Code*, 68 TEXAS L. REV. 169 (1989); Mark Snyderman, *What's So Good About*

good faith performance and very little success in agreeing on standards that might give a court guidance.

I direct my attention particularly to cases where contract terms, the law, or a combination of the two, grants discretion to one contracting party. In particular, I have in mind output and requirements contracts under section 2-306⁴, contracts permitting one party to set the price under section 2-305⁵, contracts for discretionary performance under section 2-311⁶, and contracts of indefinite duration that under section 2-309⁷ give one party the discretion to cancel. In all of these, the party with discretion must exercise that discretion in "good faith." That duty is explicitly stated in the text of the statute in sections 2-305, 2-306, and 2-311. It is brought to section 2-309 from Article 1.

To understand the problem, consider the facts of two cases. The first is *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*,⁸ a case that has been in front of the Texas Supreme Court on two occasions. In this case the buyer signed a gas purchase agreement in 1979. The contract provided for Tennessee Gas to buy the natural gas output from a tract of land in south Texas. The contract was signed when gas was in short supply as a result of the effect of price controls that had been imposed early in the 1970s. The contract stated a price, but the quantity was controlled only by the output from the tract.⁹ In the first 12 years of the contract, the seller had tendered no more than \$300,000¹⁰ dollars worth of gas in any year, but between August 1989 and August 1990, it struck an unusually rich gas deposit.¹¹ Lenape tendered \$89 million of gas in 1993.¹²

The buyer argued that it was not obliged to buy all of the gas tendered because that amount was "unreasonably disproportionate" to prior ten-

Good Faith? The Good Faith Performance Obligation in Commercial Lending, 55 U. CHI. L. REV. 1335 (1988); Mark P. Gergen, *A Cautionary Tale About Contractual Good Faith in Texas*, 72 TEXAS L. REV. 1235 (1994); Lynne N. Henderson, *Legality and Empathy*, 85 MICH. L. REV. 1574 (1987); Steven J. Burton, *More on Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497 (1984); Robert S. Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810 (1982); ROBERTO MANGABEIRA UNGER, *LAW IN MODERN SOCIETY, TOWARD A CRITICISM OF SOCIAL THEORY* (1976).

4. U.C.C. § 2-306 (1999).

5. *Id.* § 2-305.

6. *Id.* § 2-311.

7. *Id.* § 2-309.

8. 925 S.W.2d 565 (Tex. 1996).

9. *See id.* at 569.

10. *See id.* at 568 n.1.

There is no evidence in the record of the extent of the increased production. Tennessee claims that if this cause were remanded, it would show that for the first twelve years of the GPA, it never paid more than \$300,000 for gas produced in any single year. In 1993, by contrast, Tennessee claims it paid under protest \$89 million for gas produced under the GPA.

Id.

11. Lenape had been sued by its lessors for its failure to properly develop the field. *See id.* at 579.

12. *See id.* at 568 n.1.

ders or was not offered in good faith.¹³ Finding that the contract was an output contract and that a trial was needed to determine whether the amount had been tendered in good faith, the Texas Supreme Court first sent the case down for trial. Two years later, and after the composition of the Texas Supreme Court changed,¹⁴ the Court again heard the case and concluded that it was not an output contract (because the quantity was fixed) and that the quantity was tendered in good faith.¹⁵ The writer of the majority opinion in the first case wrote the dissent in the second and vice versa. While the case had a characteristic Texas flavor (what are clearly output contracts in the other 49 states are now not output contracts in Texas), it is a nice illustration of the difficulties that face a court when it must determine whether goods tendered so far exceed prior tenders or the expectation of the parties that they are considered not to be tendered in good faith.

*Empire Gas Corp. v. American Bakeries Co.*¹⁶ is the converse, a requirements contract where the buyer's requirements went to zero. In that case, American Bakeries agreed to buy its requirements of propane conversion kits for its truck fleet and thereafter to buy its requirements of propane from Empire. The parties contemplated the conversion of more than 1,000 vehicles. As seller was gearing up, buyer changed its mind and decided not to convert its vehicles.¹⁷ Its "requirements" had been reduced to zero. Arguing that the requirements had not been reduced in good faith, the seller sued.¹⁸ The buyers gave no plausible explanation why their requirements had gone to zero and they left Judge Posner—who one might expect to have been sympathetic to their case—grasping for a basis to determine whether they had acted in good faith. Because the only explanation for the change in behavior was that management (possibly new management) had changed their minds, Judge Posner concluded that the change was not in good faith and remanded for a determination of damages for breach of the contract.¹⁹

Anyone who has read the obscure comments to section 2-306²⁰ appreciates the difficulty the courts have faced in these cases. And reading

13. *See id.* at 569.

14. In the 1995 decision, Justices Phillips (C.J.), Gonzalez, Hightower, Hecht, Spector, and Owen voted to affirm the appellate court holding that a take or pay gas purchase agreement is an output contract under § 2-306 of the UCC. Justices Enoch, Cornyn, and Gammage dissented. By the 1996 rehearing Justices Gammage and Hightower had left the court and had been replaced by Justices Baker and Abbott. Justices Enoch, Cornyn, Baker, Abbott, and Spector voted in the majority after the 1996 rehearing. Justices Phillips (C.J.), Gonzalez, Hecht, and Owen voted with the majority in the first case and dissented in the second. Justice Spector voted in the majority both times. *Compare* *Lenape Resources Corp. v. Tenn. Gas Pipeline Co.*, 38 Tex. Sup. Ct. J. 1124 (1995) and *Lenape Resources Corp. v. Tenn. Gas Pipeline Co.*, 925 S.W.2d 565 (Tex. 1996).

15. *See Lenape*, 925 S.W.2d at 576.

16. 840 F.2d 1333 (7th Cir. 1988).

17. *See id.* at 1335.

18. *See id.* at 1336.

19. *See id.* at 1341.

20. What, for example, is the principled distinction between a shutdown "by a requirements buyer for lack of orders" and a shutdown "merely to curtail losses?" According to

more cases and reading the academic literature does not resolve the issue. The commentators offer many explanations about what is and what is not good faith; and courts stumble, ad hoc, from one case to another. As in *Lenape*, appellate courts are often deeply divided; there is no unanimity in the academic literature. In the following few pages, I add only a footnote to this judicial and academic debate.

Among the useful proposals in the academic literature is Professor Burton's suggestion that one should approach the problem by asking: what opportunities the contracting parties have foregone?²¹ By signing a contract, a buyer and a seller have given up certain opportunities that would have been available had they not signed the contract; presumably they have gained other, more valuable opportunities by their promises of cooperative behavior. To determine the limits of discretion granted by contracts to one of them, according to Professor Burton, one must ask what opportunities that person gave up. By signing a gas sale contract that required buyer to take seller's entire output—as determined by seller's good faith—seller must have given up the opportunity to force buyer to take at least one BTU of gas in some circumstance, otherwise the good faith restriction has no meaning.²²

the comment the former might be a permissible basis for reduction of requirements, but the latter would not.

21. See Steven J. Burton, *More On Good Faith Performance Of A Contract: A Reply To Professor Summers*, 69 IOWA L. REV. 497, 504 (1984).

I argue that the contractual expectation interest also encompasses the reasonably expected cost of performance to the promisor. I call this the "cost perspective" because it directs our attention to the other side of the coin—alternative opportunities forgone by a promisor on entering a particular contract. From the cost perspective, a person who takes the opportunity to enter a particular binding contract forgoes opportunities to employ elsewhere the resources required for the performance of that contract. A person who (intentionally) breaches a contract normally does so to redirect resources to other opportunities that turn out to be more attractive than the contract. A breach of contract thus may be described in general as a "recapture" of opportunities forgone on entering the contract. More important, a breach of contract by failing to perform in good faith can be described as a use of discretion in performance to recapture opportunities forgone on entering the contract. To determine whether a contract was breached, from the cost perspective, we ask whether the promisor in fact paid the reasonably expected cost of performance.

Whether the promisee is entitled to receive benefits claimed to be due under a contract with discretion in performance can be determined if we ask whether the promisor paid the reasonably expected cost of performance. A discretion-exercising promisor who uses its discretion to recapture forgone opportunities necessarily redirects to other opportunities the resources that were committed at formation to performance of the contract. It follows that the resources earmarked at formation for the promised performance will not be received in fact by the promisee. Harm to the promisee's expectation interest can be inferred from the promisor's recapture of forgone opportunities. Consequently, a promisor who uses discretion in performance to recapture forgone opportunities acts for an improper purpose, fails to keep its promise, and is in breach of contract.

Id. at 504-5.

22. See *id.* at 506.

So it is helpful to imagine contracting parties and hypothetically confront them with the question: Having signed this contract, what rights to raise or lower your output (or requirements or price) would you and your contracting party say you and he have foregone? Of course, this is merely a more pointed way of asking about the legitimate expectations of the parties when the contract is signed. Asking about foregone opportunities only sharpens; it does not answer.

But to answer questions about parties' expectations of others and about the measure of their own opportunities foregone, one needs to know something of the parties. Are these Good Samaritans who will pick the injured man out of the ditch and carry him to Jericho or are they Levites who pass him by?²³ Reading Llewellyn and other academic discussions of good faith, one sees little appreciation of the need to position the parties and to recognize different possible norms of behavior. There seems to be an *a priori* assumption that the person called upon to carry out the "spirit" of the contract must act like the Good Samaritan, altruistically, even in circumstances where he has some discretion that he could use to favor himself.²⁴ The importance of identifying the party and the group norms to which they ascribe and the error of making the kind of assumptions that Llewellyn and others appear to make, is emphasized by Professor Raiffa in his book on negotiation:

What norms of behavior do you expect of the "others" in your negotiation discussions? Will they tell you what they truly feel? Will they disclose all the relevant information? Will they distort facts? Will they threaten? Will they abide by their word? Will they break the law? Certainly, the modes of behavior you should expect when discussing a point of disagreement with your spouse or your business partner are different from those you can expect to occur between firms or between countries or between extortionist and victim.²⁵

23. See Luke 10:30-36 (King James).

[A] certain man went down from Jerusalem to Jericho, and fell among thieves, which stripped him of his raiment, and wounded him, and departed, leaving him half dead. And by chance there came down a certain priest that way: and when he saw him, he passed by on the other side. And likewise a Levite, when he was at the place, came and looked on him, and passed by on the other side. But a certain Samaritan, as he journeyed, came where he was: and when he saw him, he had compassion on him, And went to him, and bound up his wounds, pouring in oil and wine, and set him on his own beast, and brought him to an inn, and took care of him. And on the morrow when he departed, he took out two pence, and gave them to the host, and said unto him, Take care of him; and whatsoever thou spendest more, when I come again, I will repay thee. Which now of these three, thinkest thou, was neighbour unto him that fell among the thieves?

Id.

24. See 3 CORBIN, CORBIN ON CONTRACTS, § 570(A) (Supp. 2000) (arguing that the duty of good faith directs an interpreter to be sensitive to the "spirit of the bargain" over "the technicalities of the language"); Summers, *supra* note 3, at 827 ("It is one function of the good-faith performance doctrine to enforce the spirit of deals, including their unspecified inner logic."). See generally Jeff C. Dodd, *Time And Assent In The Formation Of Information Contracts: The Mischief Of Applying Article 2 To Information Contracts*, 36 HOUS. L. REV. 195 (1999).

25. HOWARD RAIFFA, THE ART AND SCIENCE OF NEGOTIATION 18 (1982).

Raiffa distinguishes those who might sign business contracts from others—from the strident antagonist (malevolent, untrustworthy) and from the fully cooperative partners (completely open to one another, totally honest, fully disclosing and not strategically posturing):

[Cooperative antagonists] recognize that they have differences of interests; they would like to find a compromise, but they fully expect that all parties will be primarily worried about their own interests. They do not have malevolent intentions, but neither are they altruistically inclined. They are slightly distrustful of one another; each expects the others to try to make a good case for their own side and to indulge in strategic posturing. They are not confident that the others will be truthful, but they would like to be truthful themselves, within bounds. They expect that power will be used gracefully, that all parties will abide by the law, and that all joint agreements will be honored.²⁶

I. MEASURES OF GOOD FAITH

To see how Raiffa's ideas might relate to the cases and the literature, consider some ways in which the courts and commentators have attempted to identify the boundaries of good faith in the use of contract discretion.

A. TRADE USAGE

Karl Llewellyn was confident that trade usage existed, that it could be found by courts and, when found, could give meaning to terms in contracts and to obligations among business people.²⁷ I am sure Llewellyn believed that trade usage would give ready answer to questions about good faith in many circumstances.²⁸ Llewellyn's model of a knowing and informed commercial judge seems to have been Lord Scrutton, one of whose opinions he describes as follows:

I give a single instance from a case already cited. “. . . The buyers first of all said that a shipment on October 9 is not a summer shipment, which anybody who did not know anything about the timber

26. *Id.*

27. See K. N. Llewellyn, *The First Struggle to Unhorse Sales*, 52 HARV. L. REV. 873, 874-75 (1939). Llewellyn finds much to admire in European commercial code with specialized merchant-to-merchant law, merchant juries, specialized tribunals and even “machinery” for identifying and recording trade practices.

In *Across Sales on Horseback*, Llewellyn notes that Judge Mansfield did not hear many Sales cases though he invited them. In explanation, Llewellyn hypothesizes that Sales cases may have been brought only when “custom was not clear, authoritative decision was useful, and the plaintiff wanted any question of merchants’ politics out of the picture” K. N. Llewellyn, *Across Sales on Horseback*, 52 HARV. L. REV. 725, 741-43 (1939).

28. See Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 CHI. L. REV. 710, 713 n.13 (1999). Prof. Bernstein notes the dichotomy between Llewellyn's oft stated belief in trade practice and his failure to follow through with empirical evidence to support that belief. See also David Ray Papke, *How The Cheyenne Indians Wrote Article 2 Of The Uniform Commercial Code*, 47 BUFF. L. REV. 1457, 1458-59 (1999) (probing the underpinnings of Llewellyn's belief in trade usage by looking to Llewellyn's study of Cheyenne “law-ways”).

trade would say was rather a reasonable remark. But, as the arbitrator in the timber trade finds, *and as I know the timber trade*, that is the way they would use the language." (My italics.) The sureness of understanding thus reflected is not accident. It is Scrutton. One may use of him his own description of another: "He was thoroughly acquainted with commercial law and practice; he understood what the case of the plaintiff and of the defendant was from the commercial point of view. . . ." ²⁹

But Llewellyn was famously given to elegant exaggeration. Are we to believe that an ordinary judge operating in an ordinary American jurisdiction served by ordinary lawyers will himself (or from the lawyer's evidence) understand the meaning that the trade would give to a word or to an act? That Lord Scrutton, whom Llewellyn eulogizes, knew the trade meaning of a particular phrase in a particular contract in a single case is hardly basis for that conclusion. In fact, I suggest that useful trade practice exists in only a minority, perhaps a small minority, of all cases where one might search for one.³⁰ And, equally important, I suggest that the capacity of lawyers to find and present this trade practice and of the judge or jury to understand it is even more limited.

Professor Chris Williams makes this point as follows:

Llewellyn posit[s] a world of merchants who, at some level, agree on what is reasonable commercial behavior. [He] assert[s] that courts should seek to discover the content of reasonable commercial behavior and should use that information as a basis of decision in commercial cases. [Llewellyn] has offered [no] convincing empirical evidence that such agreement exists, nor has [he] offered evidence that whatever agreement does exist is sufficiently specific to serve as a basis of decision. More importantly, by asserting that commercially reasonable behavior is objectively determinable, . . . Llewellyn ignore[s] the often antagonistic interest of participants in commercial transactions, as well as the serious disruption of relationships evidenced by resort to litigation. Ultimately, this thesis mistakes arrangements based on perceptions of economic power for arrangements that reflect mutually understood and commonly accepted trade customs.³¹

29. Karl N. Llewellyn, *On Warranty of Quality, and Society*, 36 COLUM. L. REV. 699, 707 (1936) (quoting *Ronaasen & Son v. Arcos Ltd.*, 43 Ll. L. Rep. 1, 5 (1932); Scrutton, *The Work of the Commercial Court*, 1 CAMB. L. J. 6, 16 (1932)).

30. For cases relying upon industry practice see *K.M.C. Co. v. Irving Trust Co.* 757 F.2d 752 (6th Cir. 1985) (industry practice required notice when lender was going to cancel a revolving line of credit); *Decker Steel Co. v. Exch. Nat'l Bank of Chicago*, 330 F.2d 82 (7th Cir. 1964) (rolled steel delivered at 37 inches wide is within industry norms to fill an order of 36 inch wide steel); *Gord Indus. Plastics, Inc. v. Aubrey Mfg., Inc.*, 469 N.E.2d 389 (Ill. App. 1984) (relying upon the introduction of "a booklet, published by the Society of the Plastics Industry, Inc., entitled 'Standards and Practices of Plastics Molders and Plastics Molded Parts Buyers Guide,' copyright 1965, revised 1978" which asserted that mold recovery fees were common trade practice). See also *Reid v. Key Bank, Inc.*, 821 F.2d 9, 14 (1st Cir. 1987) (bank president testified that industry custom required notice prior to bank cutting off a debtor's line of credit).

31. Chris Williams, *The Search for Bases of Decision in Commercial Law: Llewellyn Redux*, 97 HARV. L. REV. 1495, 1508 (1984).

Trade practice will not suffice. In most cases there will be no trade practice.³² The events in *Lenape*—striking unexpected gas and asserting the right to deliver it to one obliged to buy all output—seem never to have occurred before *Lenape*. There must have been thousands of cases where gas or oil was struck in unexpected quantities and where production mushroomed enormously, but none of these seem to have been subject to output contracts and thus there was neither practice nor law to guide the court in *Lenape*.

Empire Gas is easier, but here too, one might expect the trade practice concerning a buyer's right to limit its requirements to vary depending upon whether the buyer was in the business of purchasing bread crumbs,³³ converting its vehicles to propane from gasoline³⁴ or bottle manufacturing.³⁵ In each of these cases—for reasons quite mysterious and unknown to a court—the practice may have been different. Since, by hypothesis the disruptions that cause these cases are often unexpected and unusual, it is yet more likely that these events are too infrequent to form a trade practice.

But assume *arguendo* that there is a trade practice. Who is to find and explain it? Who in *Lenape* and *Empire Gas*? Except in the unusual case where the practice is written down and published,³⁶ how is the buyer or seller to discover it, how to get persuasive testimony before the court and to convince the court in the face of the defendant's objections and attempts to convince it otherwise? This "practice" is likely hard to find, variable, and, ultimately even more ambiguous than the typical writing.

I suggest therefore that trade practice will guide the parties and the courts in only a fraction of cases. The events that call into question the good faith use of discretion are idiosyncratic and uncommon, not repeated and commonplace. Even when there is a trade practice, competing experts are unlikely to agree on its terms or application.³⁷

32. See Bernstein, *supra* note 28; Richard Craswell, *Do Trade Customs Exist?*, in THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 118 (Jody S. Kraus & Steven D. Walt, eds., 2000); Papke, *supra* note 28, at 1483.

33. See *Feld v. Henry S. Levy & Sons, Inc.*, 335 N.E.2d 320 (N.Y. 1975).

34. See *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333 (7th Cir. 1988).

35. See *G.D. Searle & Co. v. Fisons Corp.*, 1993 WL 54535 (N.D. Ill. 1993) (what is "work in progress" in the bottle manufacturing industry).

36. A few trade practices are published. See, e.g., Uniform Customs and Practices Documentary Credits (UCP 500), the Clearing House Interbank Payment Systems Rules and the National Automated Clearing House Association Operating Rules. See *supra* note 30 for cases.

37. See Bernstein, *supra* note 28. Prof. Bernstein documents the absence and uncertainty of trade practice with several examples. The National Hay Association had difficulty defining a "bale" of hay and what constituted "No. 1 Hay", as well as differences between a New York "large" bale and a Western "large" bale. Industry associations, such as The National Grain and Feed Association and The Silk Association of America, provide other examples. See *id.* at 720; see also Craswell, *supra* note 32.

B. CONTEXT

Even when there is no trade practice, a contract's context will sometimes show what the parties probably intended, or would have intended, or should have intended. I believe this is true of *Lenape*. Both the buyers and sellers in *Lenape* appeared to be experienced oil and gas people.³⁸ Each of them would have understood the possibility that the seller would strike more gas on the property than was initially projected.³⁹ Each probably understood that it was not unusual for a property to produce at a relatively low level for a long time and then, with new drilling, to experience a dramatic increase in output. If each of the parties signed the output contract with that understanding, neither was entitled to think that the tender of vastly increased gas was a "foregone opportunity"—the buyer should have contemplated how it would take that gas and the seller may have carried through months of barren drilling and low output by dreams of the bonanza that awaited. I suspect that this aspect of oil and gas folklore, known to everyone, drives the majority in the second *Lenape* decision to conclude that this is not an output contract and therefore that the buyer is obliged to take all of the gas tendered.

The context could tell other things too. What if many gas contracts had quantity caps?⁴⁰ By contract, Tennessee Gas could have placed an annual cap on the amount of gas it would take, or it could have restricted its obligation to gas found above a certain elevation or in an identified reservoir. From Tennessee Gas' failure to take the precaution that others took, a court might infer that Tennessee Gas did expect or should have expected to take all of the gas produced on the property even when the volume of gas radically increased.

In *Northern Indiana Public Service Co. v. Colorado Westmoreland, Inc.*,⁴¹ Judge Easterbrook used such contracting context to find that the buying utility had a right, without violating good faith, substantially to reduce its coal requirements. Judge Easterbrook focused particularly on the history of the negotiation of the contract. As part of the negotiation, the utility rejected a minimum take requirement and a provision that would have allowed the seller to walk away if the utility had ordered too little in a particular year. There were also some parts in the negotiation

38. Tennessee Gas Pipeline Co. is in the business of transporting and storing natural gas for retailers who resell to consumers throughout the southern United States. See *Lenape Res. Corp. v. Tenn. Gas Pipeline Co.*, 925 S.W.2d 565, 567-68 (Tex. 1996).

39. The Gas Purchase Agreement between *Lenape* and Tennessee specifically authorized *Lenape* to unitize the underlying leases, to repair or rework old wells, and to drill new wells "to all depths and horizons." *Id.* at 567.

40. Quantity caps are apparently common in the industry. See *Tex. E. Transmission Corp. v. Amerada Hess Corp.*, No. CIV.A. 97-0518, CIV.A. 97-1742, 1997 WL 613125, at *16 (E.D. La. 1997) (expert witness testified that where the seller has an express right to add leases or tap new reserves, buyer quantity caps are typical). Cf. *Koch Hydrocarbon Co. v. MDU Res. Group, Inc.*, 988 F.2d 1529 (8th Cir. 1993) (a quantity cap was not included in the disputed contract because experts were predicting a shortage not a surplus).

41. 667 F. Supp. 613 (N.D. Ind. 1987).

that supported the seller's position.⁴² Relying upon these contract negotiations, the court concluded that the contract was designed to allow the buyer unilaterally to vary its requirements in a way that it reasonably believed to be in its long-term economic interest.

In many cases, there will be no reliable negotiating history or that history itself will have no clear message.⁴³ In most cases there will be no commonly understood trade context (i.e., as in oil and gas drilling where bitter disappointment is interrupted by occasional bonanzas). For example, what does context say about American Bakeries' right to reduce its purchase of components and propane? Not much. So context, like trade usage, will be useful sometimes, but only occasionally.⁴⁴

C. NOT BAD FAITH

My friend Bob Summers has written one of the best pieces on good faith. He argues that good faith has no fixed meaning, that it merely fills the void in cases where there is no bad faith. Put differently, he believes we can identify a variety of acts which constitute bad faith and that if no such acts are done by the contracting party, then the contracting party must be acting in good faith, for all other acts are done in good faith.

Professor Summers puts it as follows:

It will be argued that good faith, as used in the case law, is best understood as an "excluder"—it is a phrase which has no general meaning or meanings of its own, but which serves to exclude many heterogeneous forms of bad faith. It will also be suggested that if the Code draftsmen had perceived this, they would not have given the term the general, invariant meaning: 'honesty in fact in the conduct or transaction concerned.'⁴⁵ (footnotes omitted)

Professor Summers briefly discusses contracts under sections 2-305 and 2-306 on open price terms, requirements, and output.⁴⁶ Regrettably he

42. *Id.* at 615. A provision stating "nothing contained in this agreement shall be construed to require the use of coal for generation of electrical energy or to prohibit buyer from utilizing any and all other substitute sources of energy that may become available" was deleted from the final signed copy, but other language "nor shall anything in this Agreement be construed to prevent Buyer from operating any and all of its generating stations, [including Schahfer Unit 15 plant for which the contract served] and utilizing other source of power supply in the most efficient, economical and prudent manner. . . ." *Id.*

43. There seems to have been none in *Lenape*. See *Lenape Res. Corp. v. Tenn. Gas Pipeline Co.*, 925 S.W.2d 565 (Tex. 1996).

44. Of course one might use "context" to drive good faith entirely off the field. For example, one might say that anyone who was granted "discretion" to set price or quantity to his contracting opposite should be regarded as having given his opposite party an option to do what he pleases. The problem with that conclusion is that it leaves little or no meaning for the explicit reference to good faith in sections 2-305, 2-306, 2-311 and 2-318, and none to the duty of good faith in body in 1-203.

45. Robert S. Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 196 (1968).

46. *Id.* at 239.

satisfies himself with the citation to other work.⁴⁷ This gives us no examples about how one would distinguish bad faith from what is not bad faith in delivering high output or cutting requirements to a low amount. Since, as I have hypothesized, it would be possible for someone to tender substantially higher output or to have his requirements shrink even to zero in good faith, focusing on which of those acts is “bad faith” does little here. So, using good faith merely as an excluder in an output or requirements case would give little guidance about whether discretion granted to one party in a contract has been used in bad faith.

D. EFFICIENCY

Professor Gergen deserves credit; he at least has proposed a test that can be applied and, when applied, will tell which increases or decreases are in good faith and which are not.⁴⁸ He argues that the hypothetical parties at the contracting table—confronted with hypothetical and unexpected events—would agree to limit their discretion (to raise or lower quantity or to set price or otherwise) to efficient changes. Noting that all sales contracts are thought to be efficient changes from the status quo (that is each party expects to be made better off by the contract than he would have been had the contract not been made), he presumes that neither contracting party would expect either party to exercise discretion in a way that would not be efficient, i.e., in a way that would inflict a greater injury on the other party (as a result of the change) than the gain to himself.⁴⁹

To understand how this rule might work, consider a hypothetical case like *Lenape*. Assume for example that the seller proposed to include one million additional MMBTU of gas in its output and that the buyer would have to pay a contract price of \$3.50 per MMBTU at a time when the market was \$2.50 per MMBTU. Comparing the contract and the market price, the seller would gain \$1,000,000 by adding this to the contract quantity as compared with selling that quantity on the spot market. If the buyer (who must take the gas) would otherwise purchase one million MMBTU at \$2.50 on the spot market, his loss is the same as the seller’s gain, and the change is efficient, if only marginally so.

But assume alternatively that the buyer has other supplies that might cost only \$2.15 or \$3.00. If the \$3.50 gas will displace the \$3.00 gas, the change is efficient, for the buyer loses only \$500,000 yet the seller gains \$1,000,000. If, on the other hand, the gas that is displaced will be \$2.15 gas then the change is not efficient because the loss to buyer exceeds the gain to seller. The seller gains \$1,000,000 but the buyer loses \$1,350,000.

47. *Id.* at 240 (citing Havighurst & Berman, *Requirement and Output Contracts*, 27 ILL. L. REV. 1, 13 (1932)).

48. Mark P. Gergen, *A Defense of Judicial Reconstructions of Contracts*, 71 IND. L. J. 45 (1995).

49. *See id.* at 55-6.

Presumably Professor Gergen would find the first two tenders to be in good faith and the last one, not.

Professor Gergen's proposal is based on the hypothesis that at the time of contracting, the parties would expect one another to exercise discretion (in price or quantity) only in a way that would cause a joint benefit, i.e., that would be efficient but not such that the gain to one would be less than the loss to the other. He is projecting the parties' intentions from their obvious intention on entering the contract.

But who is to say that a cooperative antagonist—who must be cooperative during the negotiation and who must then emphasize joint values in order to get a deal—will remain cooperative when discretion is unexpectedly given to him? When he is free to make choices unilaterally, why would a cooperative antagonist act cooperatively? In a world occupied by cooperative antagonists, I doubt that Professor Gergen's hypothesis about expectations is true to life.

E. THE GOLDEN RULE

Although the majority of the academic writers and many of the cases recognize that a contracting parties' interest are often antagonistic as well as cooperative, some judges⁵⁰ and commentators⁵¹ seem to believe that the contracting party with discretion is obliged to exercise it according to the golden rule—do unto others as you would have them do unto you. In effect these commentators and courts read the contracts as though the

50. See, e.g., *Marquette Co. v. Norcem Inc.*, 494 N.Y.S.2d 511 (1985); *Oregon-Washington Vegetable and Fruit Growers Assoc., Inc. v. Sunset Packing Co. of Oregon*, 456 P.2d 1002, 1003 (Or. 1969); *Bak-A-Lum Corp. of Am. v. Alcoa Bldg. Products*, 351 A.2d 349 (N.J. 1976); *Nanakuli Paving & Rock Co. v. Shell Oil Co.*, 664 F.2d 772, (9th Cir. 1981); *Fortune v. Nat'l Cash Register Co.*, 364 N.E.2d 1251 (Mass. 1977); *Shell Oil Co. v. Marinello*, 307 A.2d 598 (N.J. 1973); *Spindle v. Travelers Ins. Co.*, 136 Cal. Rptr. 404 (Ca. Ct. App. 1977); *Brown v. Avemco Inv. Corp.*, 603 F.2d 1367 (9th Cir. 1979).

51. See, e.g., *Van Alstine*, *supra* note 3 (Van Alstine does not completely shut the door on selfish behavior by one party but the crack is narrow); *Litvinoff*, *supra* note 3, at 1673 (arguing that the doctrine of good faith is moving to advance cooperation and limit self-assertion); *McPhee*, *supra* note 3 (urging the application of good faith to prohibit professional football teams from effectively bypassing salary caps by paying bonuses in ways not contractually defined as salary); *Silkworth*, *supra* note 3, at 277 (indorsing judicial authority to make "ad hoc determinations of fairness and justice, and to limit quantity variations where justice requires" when applying good faith to output and requirements contracts); *Patterson*, *supra* note 3, at 210 (charting the "exonerable" shift from an individual autonomous model of contract to communitarian "sensibilities"); ROBERTO MANGABEIRA UNGER, *LAW IN MODERN SOCIETY, TOWARD A CRITICISM OF SOCIAL THEORY*, 209-10 (1976) (one party may never exercise its legal rights without considering the effect upon the other). Cf. *Dickerson*, *supra* note 3, at 960 (arguing that good faith and fiduciary duty are the same standard applied at different points in a relationship); *DiMatteo*, *supra* note 3, at 390,442 (viewing good faith as a "new spirit" of contract law which places parties who strictly enforce the terms of their agreements against "reasonable" requests for modification at peril of retroactive judicial reformation); *Henderson*, *supra* note 3 (assumes that individuals have a responsibility toward each other based on shared humanity and would probably view good faith as a doctrine which alerts courts and parties to moral choice and responsibility); *Duncan Kennedy*, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976) (altruism is a preferred and viable mechanism for resolving legal issues).

discretion to establish quantities or prices is modified by a term that might read as follows: "In exercising its right to set [prices, quantity] buyer shall act unselfishly and shall treat seller's interests with the same generosity as it treats its own interests." But the contracts do not say that, and, without such direction, one can expect the golden rule to be observed only by rejecting my hypothesis that business people are antagonists.

II. THE SKEPTICAL COURTS

I have found no cases that use Raiffa's terminology "cooperative antagonist" and none explicitly characterizes the incentives and motives of business contracting parties in general. Most seem not even to focus upon the incentives of contracting parties or on the appropriate expectations of one party about another's probable behavior in face of these incentives. But a handful of judges are skeptical of the golden rule and would be comfortable with Raiffa's hypothesis. It will not surprise anyone that the naughty boys from Chicago, Richard and Frank, have thought most clearly about these issues and have spoken most honestly on them. What may be surprising is that some more traditional judges whose learning pre dates the rise of law and economics, Judge Wisdom of the 5th Circuit and Judge Kennedy of the 6th Circuit, agree.

Consider *Corenswet, Inc. v. Amana Refrigeration, Inc.*⁵² Corenswet had been Amana's distributor in Louisiana for a number of years when Amana terminated the distributorship. Corenswet sought to enjoin the termination. The contract gave Amana the right to terminate "at any time and for any reason" and also allowed the distributor to opt out.⁵³ Despite the fact that Amana's cancellation seems to have been motivated at least partly by bad blood between Amana's president and the president of Corenswet's parent company,⁵⁴ Judge Wisdom found that Amana's cancellation was permissible and that it had exercised its contract rights in good faith.

Reversing the lower court's finding that the doctrine of good faith protected the distributor from Amana's termination, the Court noted that under Corenswet's theory, one would always be able to characterize a termination for no stated reason as being a "bad faith" termination. If that argument were accepted, it would likely result in the "invalidation of unrestricted termination clauses."⁵⁵

52. 594 F.2d 129 (5th Cir. 1979).

53. *Id.* at 135.

54. *See id.* at 133. There was ample evidence in the record, moreover, to support the district court's conclusion that the real factor motivating Foerstner's [of Amana] decision was animosity towards Fred Schoenfeld, the president of Corenswet's parent corporation, Select Brands, Inc. That animosity dated back to 1972, when Schoenfeld's action in protesting to Raytheon Corporation, Amana's parent, aborted Amana's attempt to transfer the distributorship from Corenswet to Corenswet's then Amana sales manager. *Id.*

55. *Id.* at 138.

The Court recognized that Amana might want to switch distributors for a variety of reasons and that the distributor might wish to abandon Amana and become a General Electric or Frigidaire dealer.⁵⁶ In effect, Judge Wisdom acknowledges that the contract recognizes the existence of selfish motives and that the doctrine of good faith does not bar either party from exercising its discretion to serve those motives.

In *TCP Industries, Inc. v. Uniroyal, Inc.*,⁵⁷ TCP had a contract to sell butadiene (a petrochemical product extracted from gas and oil and used for the production of synthetic rubber) to Uniroyal at a price set by TCP. In 1974 price controls on butadiene ended and the Arab oil embargo caused the price of oil to spike. The price of butadiene spiked too and TCP raised its contract price. Uniroyal claimed that TCP did not act in good faith in raising the price and so had broken the contract.⁵⁸ Judge Kennedy affirmed the trial court's decision that TCP had acted in good faith.⁵⁹ Relying on the negotiating context, Judge Kennedy noted that TCP negotiated the "deletion of the standard meet or release clause" and "refused to include Uniroyal's suggested right to cancel clause if the price charged for butadiene was unacceptable."⁶⁰ Judge Kennedy explicitly recognizes the proposition that TCP could charge a price above "fair market value" and yet set the price in good faith. She rejects the idea that good faith demands unselfish exercise of discretion.⁶¹

Judge Easterbrook's earliest and most widely quoted statements about good faith come in the appeal of a bankruptcy case⁶² where he overturns the order confirming Kham & Nate's reorganization plan. The opinion is best known for its commentary on the "new value" rule, but it also addresses the question whether a bank loan can be subordinated because of bank's "inequitable conduct", or because it behaved in "bad faith." Judge Easterbrook addresses the expectations of the parties as follows:

We do not doubt the force of the proverb that the letter killeth, while the spirit giveth life. Literal implementation of unadorned language may destroy the essence of the venture. Few people pass out of childhood without learning fables about genies, whose wickedly literal interpretation of their "masters'" wishes always leads to calamity. Yet knowledge that literal enforcement means some mismatch between the parties' expectation and the outcome does not imply a general duty of "kindness" in performance, or of judicial oversight into whether a party had "good cause" to act as it did. Parties to a contract are not each other's fiduciaries; they are not bound to treat customers with the same consideration reserved for their families. Any attempt to add an overlay of "just cause"—as the bankruptcy

56. See *id.*

57. 661 F.2d 542 (6th Cir. 1981).

58. See *id.* at 544.

59. See *id.* at 552.

60. *Id.* at 548.

61. See *id.* at 549.

62. See *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351 (7th Cir. 1990).

judge effectively did—to the exercise of contractual privileges would reduce commercial certainty and breed costly litigation. The UCC's requirement of "honesty in fact" stops well short of the requirements the bankruptcy judge thought incident to contractual performance. "[I]n commercial transactions it does not in the end promote justice to seek strained interpretations in aid of those who do not protect themselves."⁶³

Here is an explicit recognition of the motives of contracting parties. Judge Easterbrook reminds us that there are higher obligations than the obligation of good faith, namely the duty of a fiduciary. A fiduciary's duties to the beneficiary exceed those undertaken by contracting parties. The judge comes close to an explicit statement of Raiffa's distinction between a cooperative antagonist and a fully cooperative partner by noting that a contracting party is not bound "to treat customers with the same consideration reserved for their families."⁶⁴

Equally articulate and similarly disappointing to the party who relies upon the doctrine of good faith is Judge Posner's opinion in *Original Great American Chocolate Chip Cookies Co. v. River Valley Cookies, Ltd.*⁶⁵ In that case the cookie company terminated the Sigels' franchise. After the franchise had been terminated, the Sigels continued to sell cookies under the company's trademark but used batter purchased elsewhere.⁶⁶ The franchise contract gave the cookie company the right to cancel upon the franchisee's failure to maintain the "Cookie System Facility in a good, clean wholesome manner and in strict compliance with the standards then, and from time to time, prescribed by the Cookie Company."⁶⁷ The record showed that the Sigels had flunked a series of inspections because of "runny brownies, chewing gum stuck to counters, and ignorant and improperly dressed employees. . . ."⁶⁸

Ultimately, the Sigels argued that the cookie company's exercise of its discretion was not in good faith. Judge Posner rejected that claim with the following comment:

Contract law does not require parties to behave altruistically to each other; it does not proceed on the philosophy that I am my brother's keeper. That philosophy may animate the law of fiduciary obligations but parties to a contract are not each other's fiduciaries, even if the contract is a franchise.⁶⁹

Kham & Nate's and the *Cookie* cases are only two of half a dozen cases that Judges Easterbrook and Posner have written on the question of good

63. *Id.* at 1357 (quoting *James Baird Co. v. Gimbel Bros., Inc.*, 64 F.2d 344, 346 (2d Cir. 1933) (L. Hand, J.)).

64. *Id.* at 1357.

65. 970 F.2d 273 (7th Cir. 1992).

66. *See id.* at 275.

67. *Id.* at 278.

68. *Id.*

69. *Id.* at 280.

faith.⁷⁰ They have been consistent, clear and almost gleeful in slamming good faith arguments.

Note carefully what these cases do not say. Although the cases say that the parties and the courts must respect the language in the contracts, they do not deny the existence of the duty of good faith. It is wrong to characterize these opinions merely as “textualist” denials of the duty of good faith out of the contract. Judges Easterbrook, Kennedy, Posner, and Wisdom, as well as Professor Raiffa, would agree that there is a duty of good faith in the exercise of every obligation under the Uniform Commercial Code or under a contract that is governed by the UCC. In *Empire Gas*⁷¹ Judge Posner affirms on the basis that the bakery did not act in good faith; and Judge Kennedy is the author of *Irving Trust*,⁷² the seminal lender liability case that rested on a finding that the lender did not behave in good faith. These judges do not argue that the duty does not exist, only that the duty has less bite than its advocates claim. These judges warn against confusing the duty of good faith with fiduciary duty; they warn against identifying a cooperative antagonist as a fully cooperative partner. They do not deny the existence of the student antagonist nor do they reject the possibility that cooperative antagonist might stray beyond good faith.

III. COOPERATIVE ANTAGONISTS

So who really says business-contracting parties are cooperative antagonists? Return to the paragraphs from Professor Raiffa. He says so, does he not? And he is right. Businessmen indulge in “strategic posturing;” most are at least “slightly distrustful.” They would “like” to be truthful but are not always so.⁷³

The virtue of Raiffa’s hypothesis is that it focuses the eye on the appropriate expectations of business negotiators. Each is and can expect the other to be a cooperative antagonist. Each enters the contract only because the contract leaves him better off than no contract; otherwise he

70. See *Indus. Representatives, Inc. v. CP Clare Corp.*, 74 F.3d 128 (7th Cir. 1996); *Digital Equip. Corp v. Uniq Digital Tech. Inc.*, 73 F.3d 756 (7th Cir. 1996); *Cont’l Bank v. Everett*, 964 F.2d 701 (7th Cir. 1992); *Dyna-Tel, Inc. v. Lakewood Eng’g & Mfg.*, 946 F.2d 539 (7th Cir. 1991); *Market Street Assoc., LP v. Frey*, 941 F.2d 588 (7th Cir. 1991); *Kham & Nate’s Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351 (7th Cir. 1990); *Murphy v. White Hen Pantry Co.*, 691 F.2d 350 (7th Cir. 1982).

71. *Empire Gas Corp. v. Am. Bakeries Co.*, 840 F.2d 1333 (7th Cir. 1988).

72. *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752 (6th Cir. 1985).

73. Raiffa’s insights set his work apart from pieces like “Getting to Yes” where Professor Fisher seems to believe that good negotiators are always and only cooperative. Compare HOWARD RAIFFA, *THE ART AND SCIENCE OF NEGOTIATION* (1982) and ROGER FISHER, *GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN* (Bruce Patton ed., 1991). See also Russell Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583 (1998); Eleanor Holmes Norton, *Bargaining and the Ethic of Process*, 64 N.Y.U. L. REV. 493 (1989); Carrie Menkel-Meadow, *Toward Another View of Legal Negotiation: The Structure of Problem Solving*, 31 UCLA L. REV. 754 (1984); Gary T. Lowenthal, *A General Theory of Negotiation Process, Strategy, and Behavior*, 31 U. KAN. L. REV. 69 (1982).

would not do so. He is not animated by feelings of kindness or love toward the other party; he is animated by his selfish interest.

Certainly this antagonism is momentarily suppressed by the contract where the antagonist finds it in his interest to be cooperative with his contracting party, but Raiffa's hypothesis tells us that the antagonistic interests are only suppressed, not eradicated. Each person should expect his opposite party to exercise contract discretion in his own interest, not unselfishly, and bounded only by some outer limit of impermissible deviance from cooperative behavior⁷⁴ and if he is honest, each will acknowledge that he will use his own discretion in his own interest.

If I am correct and if each party does and should expect that discretion granted to the other will be exercised in a comparatively selfish and biased way, then courts that demand unselfishness and require observation of the golden rule are wrong. They misconstrue the contract and exaggerate the opportunities foregone. Worse, courts that unduly limit the cooperative antagonist's discretion deny that antagonist a right that he has purchased by the price that he has paid. If each party expects that discretion will be exercised in a comparatively selfish way, the price of the commodity should be adjusted accordingly to offset for that discounted possibility.⁷⁵ We should understand that our opposite party will tender every last BTU of gas if he hits a big discovery. The buyer of natural gas conversion kits will reduce his requirements to some number well below his original expectations. That being so, courts should be slow to construe selfish exercise of discretion to be in bad faith.

74. If one conceives of good faith behavior as a middle ground, bounded on the right by fiduciary duty and bounded on the left by bad faith, thinking of the party as a cooperative antagonist probably does more to draw the right hand boundary than it does to draw the one on the left. It is more likely to protect the courts against wandering into the fiduciaries' region than into the region of the strident antagonist.

75. One would expect that the buyer in *Lenape*, anticipating the small possibility that the seller would tender much more gas than the buyer wished, would somehow offset that possibility by some marginal reduction in the price or by demanding some other term in return. If in fact such a payment has been made, denial by the courts of the contracting parties right to exercise the right he has purchased violates the expectation of the parties.